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QUANTITATIVE EASING INQUIRY

0.1 What I offer is the perspective of a financial analyst to whom the inevitability of the credit crunch was very apparent prior to its occurrence in 2007/08, and also recognised that the extraordinary monetary policies would fail to deliver the promised return to growth and 'normal' inflation. The main failure appears to be the inaccuracy of standard economic models in describing how our economy works and the strong incentive for those who benefit from the repeated policy intervention in markets to maintain QE policies.

0.2 I strongly believe that QE and the permanent policy of bailing out financial markets is having a damaging impact on our economy. Rather than questioning whether further QE could contribute to future economic instability, I would argue that the permanence of QE to date has already done just that. Not only has it contributed to greater inequality and social division, QE has also encouraged larger and larger sums to chase yield, seek illiquidity and finance ever more fanciful projects that never reach positive cashflow.

0.3 Other than the emergency provision of liquidity during a crisis, we should place a cap on further QE, together with a requirement that any future program includes a timeline for exiting the policy. In implementing this change, we should remove any possibility of greater intervention in financial markets, such as the purchase of equities or related instruments by the Bank, either on or off-balance sheet. These changes would enhance the stability of the economy by reducing the incentive for financial players to push ever further into leveraged, illiquid and risky investments. Removal of the permanent 'central bank put' would demonstrate that losses, as well as gains, are privatised.

0.4 Associated with this, it would seem sensible to return control of monetary policy to the Chancellor. The period of independent central banking has demonstrated monetary policy choices to be inherently political in nature. As such, decisions are best made by an electable official that the public is able to remove from office if their actions do not contribute to economic and financial stability.

Should the Bank of England's mandate be altered?

1.0 Yes. However, rather than raising the inflation target set for the Bank, the mandate of the Bank should instead be restrained to providing emergency liquidity to solvent, but illiquid, businesses during crises.

1.1 In addition, control of monetary policy should revert to the Treasury. Throughout the period of Bank independence monetary policy has been demonstrated to be an inherently political choice. Beyond emergency liquidity interventions at the height of a crisis the transition to markets becoming a target of policy, rather than an indicator of economic and policy performance, discriminates between the asset rich and poor, between leveraged investors and

household savers, and between the old and the young. These are not decisions that should be made by unelected officials.

1.2 Returning control of monetary policy to the Chancellor may contribute to greater economic volatility around the political cycle. Nonetheless, doing so would place decisions on this key policy tool in the control of elected officials. The government would then be able to choose whether to implement further rounds of QE or signal the intention not to raise rates for an extended period and thus encourage greater financial speculation. The government would then also bear the economic, and political, consequences of that choice. Government control of monetary policy would also allow a wider set of factors to be considered in decisions, instead of the current set up that increases the dominance of financial interests over other sectors of society.

1.3 As with fiscal policy, an Office of Monetary Responsibility could be mandated to provide an independent assessment of the monetary policy choices made to the public. Rather than focus on the narrow mandate of the rate of increase in consumer prices, this Office could be tasked with the consideration of wider financial stability. In contrast to the current arrangement, should the management of the economy fail to meet prior expectations, the public would retain the ultimate sanction of removing the government from office.

1.4 The necessity of such a sweeping reform of the Bank's mandate is apparent not just from the negative spill over effects of QE, but from the fact that inflation targeting has failed. Focusing the debate narrowly on QE ignores that the fallibility of the 2% inflation target was laid bare in the credit crunch. That permanent QE has further extended these consequences, from an increasingly indebted younger generation to the growth in financial engineering in the business world and increasingly speculative behaviour of markets - demands a more radical shift.

1.5 The major challenge with inflation targeting is the narrow definition of inflation applied. Only a rapid increase in consumer prices is deemed to be problematic, other imbalances and negative consequences for society are not only ignored but encouraged in the name of the 2% CPI measured goal.

1.6 Prior to the 1930's, inflation was defined as the creation of money. Shifts in prices were the consequence of this monetary inflation.[1] On this earlier definition, QE very much fits as an 'inflation'. Rather than have broad consequences for prices, the impact of our monetary inflation has remained channelled within financial and tangible assets.

1.7 As Keynes highlighted in The Economic Consequences of Peace, an inflation will "confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some". The experience of QE sits neatly with that characterisation. Among the many indicators of inflationary excess, the 'gamification' of investing points to the kind of destabilising imbalances that inflation targeting is supposed

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[1] On the Origin and Evolution of the Word Inflation by Michael F. Bryan, 15 October 1997, https://www.clevelandfed.org/~/media/content/newsroom%20and%20events/publications/economic%20commentary/1997/ec%2019971015%20on%20the%20origin%20and%20evolution%20of%20the%20word%20inflation%20pdf.pdf

to banish. It is unsurprising that narrow financial interests, who benefit from inflation targeting and QE, do not wish to see conditions change. This is hardly reason to suggest policy has not created an extraordinary and destabilising inflation in asset prices. A wider mandate based on a broader definition of maintaining financial stability, with responsibility for carrying out policy transferred back to the Chancellor would at least allow financial imbalances to be considered in deliberations.

What were the original objectives of Quantitative Easing and have they changed?

2.1 Others providing evidence will provide better testimony as to whether the objectives of QE have changed. However, it is worth recalling that as early as March 2009, the Bank was discussing the exit strategy from unconventional measures. See Spencer Dale 27 March 2009[2], as an example that QE was originally intended as a temporary intervention, and that conventional policy measures would soon return. (It is fair to highlight that market forecasts, typically using similar economic models as the Bank, equally pointed to an expectation of 'normalised' growth, inflation and interest rates within a few years of the crisis).

Has Quantitative Easing been successful and how should success be measured?

3.1 Given that QE does not appear to have been designed to be permanent, and the Bank's record on achieving its growth and inflation forecasts is exceptionally poor it is hard to judge QE as a success.

3.2 As with measuring the success of inflation targeting, we would likely get a vastly different picture between the peak of the economic cycle against a view that is able to take in all of the costs. Given that QE has not, and likely cannot, be fully unwound it is questionable whether any success can be measured.

What have been its distributional effects?

Damaging.

4.1 As others have pointed out in previous testimony to the committee, 80% of bank lending is asset based. A policy that pursues the inflation of asset prices will disproportionately benefit the wealthy to the disadvantage of others. A decade ago, the NAPF was already decrying the negative effects of QE on corporate pensions, as the drop in bond yields weakened funding.

4.2 How many workers have had their wages capped, and working conditions deteriorate, because of a merger financed by cheap debt that has reduced the choice of employers locally? How many will lose their jobs because the leverage

[2] Tough times, unconventional measures, Spencer Dale, 27 March 2009, https://www.bankofengland.co.uk/news/2009/march/tough-times-unconventional-measures-speech-by-spencer-dale

encouraged by finance meant that the company was vulnerable to any deterioration in conditions?

4.3 Quantifying the impact of QE, and inflation targeting, is near impossible.

Could the expansion of Quantitative Easing in the UK create the possibility of economic stability being undermined in the future? If so, how?

5.1 Other submissions to the commission have raised concerns about the imminence of a faster increase in consumer prices based on the expectation of looser fiscal policy following the pandemic.

5.2 The counterfactual from Japan suggests otherwise. Intervention by the Bank of Japan has covered a large proportion of bond issuance by the government since the appointment of Governor Kuroda in 2013. Furthermore, the Bank of Japan has resorted to buying baskets of Japanese equities for much of the last decade as it has made efforts lift the increase in consumer prices to 2%. Nonetheless, as in the UK, the increase in consumer prices has continued to undershoot both the forecasts made by the Bank and the official target.

5.3 Could the expansion of QE increase the likelihood of more economic instability in the future? There seems little doubt that this will be the case. Banks failures are unlikely to be the main source of fragility this cycle, the same can be said of any cycle. After the tech bust at the turn of the Millennium and the excess leveraging of the corporate sector, hot money headed to housing and related derivative instruments. When that bubble burst, investors gravitated to commodities and the economies of the emerging world that had seemingly side-stepped the worst effects of the credit crunch. As more official intervention has been used to offset the consequences of this downturn, illiquidity assets, alternative investments and 'growth story stocks' have attracted ever larger funds as the hunger for return above the paltry returns on cash has grown.

5.4 As with the belief in boom without bust ahead of the credit crunch, the confidence in the speed of central bank intervention has a Pavlovian effect on investors. Despite the severity of the Covid downturn, the fragility of the economy was already apparent. Though Bank policy had not changed since the summer of 2018, 10-year gilt yields fell from above 1.5% to 0.5% in late 2019 as confidence in the outlook waned. This was despite unemployment being at its lowest level in decades. QE, as initially described, was supposed to kick start aggregate demand and encourage businesses to invest. Why risk expanding new capacity when management recognises that current demand is artificially stimulated? Why take the risk in new innovation that might take years to deliver when financial engineering can deliver the short-term rewards with much greater certainty? The distorted incentives encouraged by QE, and the policy of permanently targeting policy at financial markets have exacerbated the fragility of our economy caused by poor competition policy and social inequality.

5.5 The challenges of our modern economy, and the complexity of actions required by a central bank, have clearly changed dramatically with technological advance. Yet, at every stage, it appears that the inflation targeting mantra has

accentuated the privatisation of gains and the socialisation of losses. QE has extended this problem through the deliberate targeting of the 'portfolio balance channel' and the incentive this creates to financial engineering.

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